Supreme Court, U.S.
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IN THE

Supreme Court of the United States

ALAN FURST, M.D.;
MICHAEL S. HARRISON, ESQ., Individually and on behalf of all persons similarly situated,

Petitioners,

v.

STEPHEN FEINBERG; DANIEL CROWLEY; CERBERUS PARTNERS, L.P.; SACHS CREDIT PARTNERS, L.P.; FOOTHILL CAPITAL CORPORATION; SCOTT R. DANITZ; SCOTT T. LARSEN; ALLEN J. MARABITO; DOMENIC A. MEFFE; VITO PONZIO, JR.; JOSEPH D. SMITH; RICHARD M. SMITH; DONALD J. AMARAL; WILLIAM J. CASEY; L. PETER SMITH; SANDRA L. SMOLEY; RICHARD A. FINK; STEPHEN G. PAGLIUCA; JOHN DOES 1-100; CERBERUS ASSOCIATES, L.L.C.; CERBERUS CAPITAL MANAGEMENT, L.L.C.; CRAIG COURT, INC.; GOLDMAN SACHS CREDIT PARTNERS, L.P.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

This case arises from fraudulent bankruptcy announcements in August and September of 2000 by the officers, directors, and major lenders of an extremely promising public corporation, Coram Healthcare Corporation ("Coram"). The announcements, which had the effect of artificially deflating the market price of Coram common stock to a fraction of its true value, created the false impression that Coram's bankruptcy filing and emergence from bankruptcy proceedings as a "private corporation" owned solely by its major lenders, a course of action that would completely wipe out the equity of existing shareholders without any compensation, represented the only viable option for resolution of a problem critical to Coram's survival.

What the announcements failed to disclose was that Coram's proposed bankruptcy reorganization plan not only was *not* the only viable option, there was a significant likelihood that it could not be implemented. Indeed, unbeknownst to petitioners and a class of thousands of others who sold their Coram stock in response to these announcements, there was a valid legal basis for *opposing* that plan. That is, (1) Coram's entire operations were tainted by the existence of a secret agreement between Coram's chief executive officer and one of its major lenders, involving hidden compensation of approximately $1 million per year, in return for his agreement to place the lender's interests before the interests of either Coram or its shareholders; and (2) as a result of these facts, it was likely that Coram's proposed bankruptcy reorganization plan would be *rejected* by the bankruptcy court, leaving as the only real option a "debt to equity" exchange by Coram's major lenders, an undisclosed alternative that would merely dilute their equity without wiping it out completely, and was therefore far more

favorable to Coram's shareholders. Indeed, it was only *after* the above-referenced class sold their shares for pennies on the dollar that the secret agreement was disclosed and, as a result, the bankruptcy court rejected Coram's proposed bankruptcy reorganization plan, the purported only available course of action. Immediately after its rejection, the undisclosed option of a debt to equity conversion by Coram's major lenders was implemented. Upon disclosure of these facts, the market price of Coram stock rose dramatically.

The questions presented for review are:

1. Whether, under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 (the "Exchange Act"), an announcement of a proposed course of action by a public corporation that threatens to eliminate shareholders' equity, one that is presented as the only viable option, must disclose the existence of facts that would provide shareholders with a legal basis for *opposing* the action, so that they may salvage their investments rather than selling their shares at diminished prices, even when such facts might otherwise amount only to corporate mismanagement or a breach of fiduciary duty.

2. Whether, under Section 10(b) and Rule 10b-5 of the Exchange Act, an announcement of a proposed course of action by a public corporation that describes the elimination of shareholders' equity as the only available course of action for resolution of a problem critical to its survival must disclose the existence of other options known to exist, and which are rendered viable by other undisclosed facts, even if there is no certainty that the other options will be implemented.

PARTIES TO THE PROCEEDING

Petitioners

Petitioners are former shareholders of Coram Healthcare Corporation ("Coram"), who sold the shares of Coram common stock they had been accumulating over a period of some five years, when respondents falsely announced in August and September of 2000 that Coram's bankruptcy filing, and its emergence from bankruptcy proceedings as a "private corporation" owned solely by respondent Cerberus and Coram's other major lenders, represented the only viable option for compliance with a statute critical to Coram's survival.

Respondents

Respondents include the Chief Executive Officer (CEO) of Coram, Daniel Crowley ("Crowley"), one of Coram's major lenders, Cerberus Partners, L.P. ("Cerberus"), and Stephen Feinberg ("Feinberg"), the CEO of Cerberus, and a former director of Coram.

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STATEMENT OF JURISDICTION

The judgment of the Third Circuit Court of Appeals was entered on December 18, 2002. The Court of Appeals entered an order denying a timely petition for rehearing *en banc* on January 14, 2003.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

This case involves the following statutory provisions:

15 U.S.C. § 78j, Section 10 of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5.

Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, provides in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
>
> . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5 (1976), provides:

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

This Petition seeks to resolve a conflict among the circuits regarding application of this Court's ruling in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 51 L. Ed. 2d 480, 97 S. Ct. 1292 (1977), and in so doing to overturn an egregious miscarriage of justice which, if allowed to stand, will not only result in the loss of millions of dollars for petitioners and the class of investors they seek to represent, but also threatens to further damage the already fragile base of investor confidence in our public securities markets.

Prior to August of 2000, petitioners were long-term investors in Coram Healthcare Corporation ("Coram"), a corporation operating in a cutting edge area of the healthcare industry involving the delivery of healthcare infusion services to the home. Petitioners had been accumulating the common stock of that corporation for almost five years when, in August of 2000, Coram announced its bankruptcy filing and its intention to emerge from bankruptcy proceedings as a "private" corporation, owned solely by its lenders, pursuant to a bankruptcy reorganization plan. The plan was described as designed to bring Coram into compliance with "Stark II," a federal statute prohibiting a healthcare corporation from accepting referrals from physicians with ownership interests in the corporation. Pet. App., 3a. *The proposed reorganization plan* made no provision whatsoever for compensation to thousands of common stock shareholders whose interests were to be eliminated completely. *Id.* at 4a-5a. In a second announcement, in September of 2000, Coram asserted that there were "no viable options for new financing," and that "the value of the company was less than the value of the debt. . . ." *Id.* at 5a.

The combined effect of these announcements was to create the impression that Coram could comply with "Stark II" *only* by restructuring itself as a private corporation, and that it would be a private corporation by December 31, 2000. *Id.* at 7a. Petitioners sold their stock in Coram for pennies on the dollar in response to these announcements. But the announcements failed to disclose that respondent Daniel Crowley ("Crowley"), the CEO of Coram, had been secretly employed by one of Coram's major lenders, respondent Cerberus Partners, L.P. ("Cerberus"), since November of 1999, and was secretly being paid an annual salary of almost $1 million by Cerberus in return for his agreement to operate Coram *for the benefit of Cerberus*, rather than for the benefit of Coram's shareholders. *Id.* at 4a-5a. The announcements also failed to disclose that a debt to equity conversion by Coram's major lenders was another viable course of action that could also bring Coram into compliance with "Stark II," by increasing its stockholders' equity to *above* the point of $75 million, and thereby making it possible for Coram to qualify for an exemption from Stark II for public corporations engaged in the delivery of healthcare services with stockholders' equity at or above that level. *Id.* at 7a.

Petitioners, and the class they seek to represent, were lulled into acceptance of respondents' announcements falsely asserting that Coram's bankruptcy filing, and its emergence from bankruptcy proceedings as a "private" corporation, truly represented the only viable option for compliance with "Stark II." As a result, they sought to salvage what they could of their investments by selling them at fire sale prices. However, a small group of other shareholders proceeded to *oppose* Coram's bankruptcy reorganization plan. It was during the course of discovery, in connection with that

opposition, that the existence of the secret employment agreement between respondents Crowley and Cerberus was uncovered, and then brought to the attention of the bankruptcy court. In light of these facts, the bankruptcy court *rejected* Coram's proposed bankruptcy reorganization plan, ruling that Coram's entire operations had been "tainted" by the existence of this secret employment agreement. Following the rejection of that plan, in December of 2000, Coram immediately negotiated a debt to equity exchange with its major lenders in order to increase its stockholders' equity to above the level of $75 million, and thereby qualify Coram for an exemption from Stark II *while remaining a public corporation. Id.* This course of action was much more favorable to existing shareholders because, although it diluted shareholders' equity, it did not wipe out shareholders' equity completely as the bankruptcy reorganization would have done. As a result, when these facts were disclosed, the price of Coram common stock increased more than tenfold over the price at which petitioners sold their Coram stock immediately following the August and September, 2000 bankruptcy announcements.

Petitioners instituted this action when they learned of the existence of the secret employment agreement between Crowley and Cerberus, and that an option for Coram's compliance with "Stark II" that had not been disclosed to them at the time their decisions to sell their Coram common stock were made, a debt to equity exchange with Coram's major lenders, was the one that Coram and its lenders ultimately embraced. Nevertheless, the district court and the Third Circuit Court of Appeals ruled that petitioners failed to state a claim under Section 10(b) and Rule 10b-5 of the Exchange Act. Relying upon this Court's ruling in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 51 L. Ed. 2d 480,

97 S. Ct. 1292 (1977), the courts below ruled that the fact that Coram was secretly being controlled by one of its major lenders, and the existence of the secret employment agreement between Coram's CEO, respondent Crowley, and Coram's major lender, respondent Cerberus, constituted mere "mismanagement" or a "breach of fiduciary duty" that was not actionable under the federal securities laws, and therefore not required to be disclosed to petitioners at the time of their sales of Coram stock. Pet. App. 5a-6a. The Third Circuit also ruled that the failure to disclose the second option of a debt to equity exchange was not a violation of the federal securities laws because "debt-equity exchanges could take place only at the option of [the lenders]." *Id.* at 7a.

REASONS FOR GRANTING THE PETITION

I. The Third Circuit's Decision Conflicts With Decisions of Other Circuits.

In its ruling in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, this Court held that Section 10(b) and Rule 10b-5 "did not seek to regulate transactions which constitute no more than internal corporate mismanagement." *Id.* at 479. However, the Court was careful to note that when corporate mismanagement, or a breach of fiduciary duty by the officer or director of a public corporation is accompanied by acts of dishonesty and deception, that statute should be read "flexibly, not technically and restrictively" to provide a cause of action "for any plaintiff who 'suffer[s] an injury as a result of deceptive practices touching its sale [or purchase] of securities. . . .'". *Id.* at 475-476.

A. The Second And Seventh Circuits Have Held That, Under Rule 10b-5, A Breach of Fiduciary Duty That Lulls Purchasers or Sellers of Securities Into Foregoing A Legal Remedy Must Be Disclosed.

At least two Circuit Courts of Appeal have concluded that this Court's ruling in *Santa Fe* provides no barrier to recovery under Section 10(b) and Rule 10b-5 when the failure to disclose corporate mismanagement or a breach of fiduciary duty has the effect of lulling purchasers or sellers of securities into foregoing a legal remedy that might otherwise have been available them. *See, e.g.*, *Goldberg v. Meridor*, 567 F.2d 209, 212, 218-21 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069, 55 L. Ed. 2d 771, 98 S. Ct. 1249 (1978) (minority shareholder of corporate subsidiary alleging deceit in two press releases failing to disclose the conflicts of interest of the majority shareholders in proposed transaction with corporate subsidiary and its parent stated a valid claim under Rule 10b-5 on the grounds that, as a result of the nondisclosures, he was deprived of opportunity to seek to enjoin the transaction); *Ray v. Karris*, 780 F.2d 636, 642 (7th Cir. 1985) (agreeing that full disclosure policy of Act is implicated even in cases involving breach of fiduciary duty where deception serves to deprive a party of its preventive remedies under state law, but distinguishing *Goldberg* on the grounds that the alleged fraud was known to all the shareholders prior to the actual consummation of the transaction.); *Field v. Trump*, 850 F.2d 938, 948 (2d Cir. 1988) (disclosure is required where remedy is available to prevent irreparable injury from willful misconduct of a self-serving nature and nondisclosure will lull shareholders into foregoing remedy), *cert. denied*, 489 U.S. 1012, 109 S. Ct. 1122, 103 L. Ed. 2d 185 (1989).

B. The Third Circuit's Ruling In This Case Holds That, Under Rule 10b-5, A Breach of Fiduciary Duty That Lulls Purchasers or Sellers of Securities Into Foregoing A Legal Remedy Need Not Be Disclosed.

As noted above, the false assertion that Coram's proposed bankruptcy reorganization plan, and its emergence from bankruptcy proceedings as a "private" corporation owned solely by its lenders, represented the only viable option for compliance with "Stark II," lulled petitioners and the class of other sellers they seek to represent into foregoing the remedy of opposing Coram's proposed bankruptcy reorganization plan in bankruptcy court. Indeed, respondents had a strong motivation for achieving precisely this result. By falsely characterizing Coram's bankruptcy filing and its emergence from bankruptcy as a private corporation owned solely by themselves as the only viable option, respondents knew they were likely to discourage shareholders from opposing the conversion of the equity in Coram stock solely to themselves. As a result of this deception, petitioners and the class unnecessarily sold their shares of Coram stock at sharply diminished prices.

Nevertheless, in direct contrast to the positions taken by the Second Circuit in *Goldberg v. Meridor* and *Field v. Trump*, and by the Seventh Circuit in *Ray v. Karris*, the Third Circuit rejected these facts as a basis for any claim. The only statement made by the Court of Appeals regarding petitioners' forfeiture of their legal remedies and sale of their stock at a fraction of their respective purchase prices, in reliance upon the misleading announcements falsely asserting that Coram's bankruptcy reorganization plan represented the only viable option, was its observation that ". . . shareholders who sell

their shares always forfeit the right to sue in derivative claims." Pet. App. 11a. Ironically, this statement appears to place the onus for the deception that petitioners were faced with, at the time they made their decisions to sell their Coram stock, upon *the petitioners themselves*, suggesting that whatever losses they sustained were the fault of petitioners and the other shareholders who "*chose* to sell their shares" in response to the fraudulent bankruptcy announcements. *Id.* at 10a-11a. (emphasis in original). Seemingly ignored is the critical issue: that petitioners, and the other selling shareholders were deprived of the material information they needed to make informed decisions, at the time their decisions to sell were made. Most importantly, however, this statement also makes it clear that, unlike the Second and Seventh Circuits, the Third Circuit Court of Appeals finds no merit in the contention that this Court's ruling in *Santa Fe* does *not* preclude an action under Section 10(b), and Rule 10b-5, when the failure to disclose corporate mismanagement or a breach of fiduciary duty has the effect of lulling purchasers or sellers of securities into foregoing a legal remedy that might otherwise have been available to them.

Significantly, the Third Circuit's reliance upon this Court's ruling in *Santa Fe* overlooks the important distinctions between the facts presented in that case, and the facts presented here. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, the minority shareholders who objected to the terms of a merger possessed an appraisal remedy in Delaware state court, which they chose not to pursue, electing instead to bring an action in federal court on behalf of the corporation and other minority stockholders under Section 10(b) and Rule 10b-5, seeking to set aside the merger or to recover what they claimed to be the fair value of their shares. *Id.* at 466-467. In this case, while petitioners had a legal

remedy, they could have exercised that remedy only if they were not misled prior to the time they exercised their investment decisions. In the event, petitioner alleges that he and the class were misled and that they learned of the facts relating to the deception only *after* the stock had been sold.

The significance of this distinction was recognized by the Second Circuit Court of Appeals in *Goldberg v. Meridor*, 567 F.2d 209, 220, where, in the face of the similar facts presented in that case, the Second Circuit noted that:

> . . . The availability of injunctive relief if the defendants had not lulled the minority stockholders of UGO into security by a deceptive disclosure, as they allegedly did, is in sharp contrast to *Green*, where the disclosure following the merger transaction was full and fair, and, as to the pre-merger period, respondents accepted "the conclusion of both courts below that under Delaware law they could not have enjoined the merger because an appraisal proceeding is their sole remedy in the Delaware courts for any alleged unfairness in the terms of the merger . . ."

Goldberg v. Meridor, 567 F.2d 209, at 220.

This language in *Goldberg* highlights the sharp contrast between the Third Circuit's reasoning in this case and the conclusion of other Circuit Courts of Appeal that where, as in this case, an available legal remedy is *lost* as the result of deception in connection with the purchase or sale of securities, this Court's ruling in *Santa Fe* does not preclude recovery under Section 10(b) and Rule 10b-5 of the Exchange Act.

II. Petitioners, Who Suffered Injury As A Result Of Deceptive Practices Touching Their Sale of Securities, Were Deprived Of A Cause of Action For Recovery of Their Losses Through Misapplication Of This Court's Ruling In *Santa Fe*.

The Third Circuit's holding in this case is not only inconsistent with this Court's ruling in *Santa Fe*, it also overlooks the fundamental principles of "full disclosure" which this Court has embraced and reiterated as the underlying philosophy of our federal securities laws on numerous occasions over the last half century. *See, e.g., Affiliated Ute v. United States*, 406 U.S. 128, 151 (1972); *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963). In its narrow focus upon the issue of whether some or all of the conduct complained of could be characterized as either "mismanagement" or a "breach of fiduciary duty" (Pet. App. 5a-8a), the Third Circuit failed to recognize the dishonesty and deception on the part of respondents in the instant case, and the injury to petitioners flowing directly therefrom.

A. The Failure To Disclose The Secret Employment Agreement.

The Third Circuit held that the mere failure to disclose the existence of the secret employment agreement between Crowley and Cerberus does not, by itself, give rise to a valid claim for relief under Rule 10b-5. *Id.* at 6a. However, when respondents publicly announced that Coram's bankruptcy filing, and its proposed emergence from bankruptcy proceedings as a "private corporation," represented the only viable option for compliance with "Stark II," the secret

employment agreement between respondents Crowley and Cerberus *became* a material fact; i.e. its existence had a direct bearing upon the likelihood that Coram's proposed bankruptcy reorganization plan would be accepted by the bankruptcy court. As such, the existence of the secret agreement was relevant to what was described as the *only* viable option under the circumstances Coram faced. Accordingly, the existence of the agreement became a fact the disclosure of which was "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . ." Rule 10b-5(b).

Nevertheless, erroneously considering itself to be bound by this Court's prior ruling in the *Santa Fe* case, the Third Circuit overlooked these circumstances. It refused to recognize, as has the Second and Seventh Circuits, that an exception must be carved out of this Court's ruling in *Santa Fe* to cover those circumstances where the failure to disclose corporate mismanagement or a breach of fiduciary duty has the effect of lulling purchasers or sellers of securities into foregoing a legal remedy that might otherwise have been available them. Petitioners respectfully submit that, without such an exception, this Court's stated objective in *Santa Fe* of preserving a cause of action "for any plaintiff who 'suffer[s] an injury as a result of deceptive practices touching its sale [or purchase] of securities. . . .'" (430 U.S. at 475-476), would paradoxically be frustrated by that case's own language – exactly as occurred here.

B. The Failure To Disclose The Second Option Of A Debt To Equity Exchange.

The Third Circuit's conclusion that the failure to disclose the alternative option of a debt to equity conversion was not misleading, because that alternative could only take place at the "option" of Coram's lenders (Pet. App. at 7a), is also at odds with the philosophy of "full disclosure" underlying our securities laws. This Court's ruling in *Basic v. Levinson*, 485 U.S. 224 (1988), is a case in point. In *Basic v. Levinson*, as here, at issue was the requirement for disclosure of business activity that was purely discretionary in nature, in that case preliminary merger discussions. Like the District Court and the Third Circuit in this case, the District Court in *Basic* held that, as a matter of law, since the consummation of the merger was uncertain, any misstatements regarding the existence of merger discussions were immaterial and need not be disclosed, because they were not "destined, with reasonable certainty, to become a merger agreement in principle." *Id.* at 229. Faced with these facts, this Court rejected the same type of "bright line" materiality test adopted by the Third Circuit here, and held instead that, with respect to contingent or speculative information or events, materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity," and upon the "significance the reasonable investor would place on the withheld or misrepresented information . . ." *Id.* at 238-240.

In this case, the Third Circuit failed to consider these issues. Instead, the Third Circuit applied a "bright line" test of materiality, holding that the option of a debt to equity conversion did not have to be disclosed merely because it

was within the "option" of Coram's major lenders as to whether or not they would embrace that option. Pet. App. at 7a. However, if the Third Circuit had applied this Court's ruling in *Basic v. Levinson*, 485 U.S. 224, the Court would have recognized that, given respondents' representations that Coram's bankruptcy reorganization plan was the only viable option for compliance with "Stark II," they were also obligated to disclose facts making that option, in fact, less likely, and to disclose the existence of other viable options known to exist. Indeed, based upon the facts presented here, the one alternative that respondents chose to disclose, Coram's proposed bankruptcy reorganization plan, was in reality far *less* certain than the undisclosed option of the debt to equity exchange that was actually implemented.

Without any reference to the facts in this case, the Third Circuit described the alternative course of action that was ultimately taken as "optional." Pet. App. at 7a. However, disclosure of the secret agreement to the bankruptcy court materially increased the likelihood that the Court would reject the "going private" option and the likelihood that Coram's major lenders would view the "optional" alternative of a debt to equity conversion as the only viable one. In fact, when Coram's bankruptcy reorganization plan was rejected, and their effort to convert Coram from a public to a private corporation was stymied, Coram's major lenders were confronted with a Hobson's choice: if they did nothing, they would risk the immediate cessation of Coram's entire business operations, and face the prospect of a complete default by Coram on over $200 million of outstanding loans to Coram. Since they had already caused Coram to publicly announce that, as of December 31, 2000, it could no longer comply with "Stark II" while remaining a public corporation, there was no way respondents could continue Coram's

operations past that date, without complying with "Stark II," once Coram's proposed reorganization to a "private" corporation was rejected. The only other alternative for Coram's major lenders was to convert enough of their own debt to equity in Coram to increase stockholders' equity to above the level of $75 million, and by so doing bring Coram into compliance with "Stark II" while it *remained* a public corporation, and thereby protect their own investments in Coram by enabling it to continue its business operations. Not surprisingly, this latter course of action is the one Coram's lenders quickly embraced.

The Third Circuit's conclusion that, in the face of the facts presented here, the second option of a debt to equity exchange by Coram's major lenders and the existence of the secret employment agreement between Crowley and Cerberus did not constitute "material facts" that were not required to be disclosed represents precisely the type of "paternalistic" view of disclosure that this Court has specifically found to be in conflict with the philosophy of full disclosure underlying our federal securities laws. *See, e.g., Basic v. Levinson*, 485 U.S. 224, 234. (1988). Commenting on a similar approach at issue in that case, this Court noted that it assumed that "investors are nitwits, unable to appreciate – even when told – that mergers are risky propositions up until the closing." *Id.* By the same token, the approach taken by the Third Circuit in this case assumed that Coram's shareholders were unable to appreciate the risks that a proposed debt to equity conversion by its major lenders might be rejected by them, as contrary to their own economic interests, notwithstanding the effect that disclosure of the secret agreement between Crowley and Cerberus was likely to have on the viability of all other options. But here, as in *Basic*, the "role of the materiality requirement" is not to

"attribute to investors a child-like simplicity, an inability to grasp the probabilistic significance of negotiations," but to filter out only essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making his investment decision. *Id.*, citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), at 448-449. By contrast, the Third Circuit's ruling effectively permitted respondents, and would encourage other corporate insiders to *conceal* from investors the "probabilistic significance" of facts that would clearly alter the total mix of information available to them. *Cf.*, *Basic v. Levinson*, 485 U.S. 224, 234.

III. The Question Presented Is An Important One.

At a time in our nation's history when widespread fraud by corporate insiders has already shaken the confidence of public investors in the integrity of our securities markets, however unwittingly, the Third Circuit's decision in this case threatens to undermine that confidence even further.

If the Third Circuit's holding in this case is allowed to stand, investors as well as corporate insiders will also be invited to conclude that the federal securities laws are not violated by the failure to disclose secret agreements and hidden compensation arrangements that directly impact upon the viability of a course of action falsely described as the only viable option for resolution of a problem critical to a public corporation's survival. The inference to be drawn from decisions like this one is that corporate insiders with the savvy to navigate the "technicalities" of our securities laws can still avoid liability under Section 10(b) and Rule 10b-5 for even an outright falsehood, relied upon by thousands of investors in connection with their decision to purchase or sell securities.

This Court's seminal ruling in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, has become an integral part of the fabric of our federal securities laws over the last twenty-five years. It is for this very reason, however, that this Court should consider revisiting and reaffirming its ruling in the *Santa Fe* case, to insure that misapplication of that ruling, in the manner that this was done by the Third Circuit here, will either be minimized or eliminated completely. As this case and others like it demonstrate, in the twenty-five years since the *Santa Fe* case was decided, the creativity of unscrupulous corporate insiders in the use of deceptive tactics in connection with the purchase and sale of securities has only expanded. In addition, often the existence of a legal remedy is all that is left to shareholders who become the victims of acts of deception by corporate insiders, in connection with their purchase or sale of securities. Any suggestion that such deception will not give rise to liability under the federal securities laws, or that even their legal remedies can be lost, as long as the deception is accompanied by, or arises from corporate misconduct that might otherwise be described as "internal mismanagement," or a "breach of fiduciary duty," should be emphatically rejected.

Given the increasing importance of deterring corporate fraud; the mischief that can be perpetrated by unscrupulous individuals and companies who, like respondents here, would not hesitate to surreptitiously seize control of a public corporation through unlawful means, and then cause the corporation to issue misleading public announcements designed solely to advance their own interests; and the differing views that are possible on the issue of whether injury has been suffered as the result of deception, in connection with the purchase or sale of securities, this Court should now

resolve the split in the decisions by various Circuit Courts of Appeal on the issue presented here, by explicitly holding that a valid claim recovery can be made under Section 10(b) and Rule 10b-5 when the failure to disclose corporate mismanagement or a breach of fiduciary duty has the effect of lulling purchasers or sellers of securities into foregoing a legal remedy that might otherwise have been available them. Such a decision would serve to clarify the law on this issue, and reaffirm the important principle that our federal securities laws can and do provide for recovery whenever, and wherever "any plaintiff 'suffer[s] an injury as a result of deceptive practices touching its sale [or purchase] of securities. . . .'". *Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, at 475-476.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED DECEMBER 13, 2002 AND FILED DECEMBER 18, 2002

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 02-2357

ALAN FURST, M.D.;
MICHAEL S. HARRISON, ESQ., Individually and on behalf of all persons similarly situated,

Appellants

v.

STEPHEN FEINBERG; DANIEL CROWLEY; CERBERUS PARTNERS, L.P.; SACHS CREDIT PARTNERS, L.P.; FOOTHILL CAPITAL CORPORATION; SCOTT R. DANITZ; SCOTT T. LARSEN; ALLEN J. MARABITO; DOMENIC A. MEFFE; VITO PONZIO, JR.; JOSEPH D. SMITH; RICHARD M. SMITH; DONALD J. AMARAL; WILLIAM J. CASEY; L. PETER SMITH; SANDRA L. SMOLEY; RICHARD A. FINK; STEPHEN G. PAGLIUCA; JOHN DOES 1-100; CERBERUS ASSOCIATES, L.L.C.; CERBERUS CAPITAL MANAGEMENT, L.L.C.; CRAIG COURT, INC.; GOLDMAN SACHS CREDIT PARTNERS, L.P.

On Appeal From the United States District Court
For the District of New Jersey
(D.C. Civil Action No. 00-cv-05509)
District Judge: Honorable Katharine S. Hayden

Appendix A

Submitted Pursuant to Third Circuit LAR 34.1(a)
December 13, 2002

BEFORE: FUENTES and STAPLETON, *Circuit Judges*, and O'KELLEY,* *District Judge*

(Opinion Filed: December 18, 2002)

OPINION

STAPLETON, *Circuit Judge*:

I.

This is an appeal from a District Court order dismissing Plaintiffs' complaint with prejudice under Rule 12(b)(6) of the Federal Rules of Civil Procedure. Appellants are former stockholders of Coram Healthcare Corporation ("Coram"), who, in this class action, raise claims (1) for material misstatements or omissions under § 10(b) of the Securities Exchange Act of 1934 and under Rule 10b promulgated thereunder, (2) for control person liability under § 20(a), (3) for breach of fiduciary duties owed directly to Appellants, and (4) for other common law torts. The Defendants/ Appellees are Stephen Feinberg ("Feinberg"), Daniel Crowley ("Crowley"), and Cerebus Partners, L.P. ("Cerebus" and, collectively, "Appellees").

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* Honorable William C. O'Kelley, United States District Judge for the Northern District of Georgia, sitting by designation.

Appendix A

Coram is a public corporation, formerly traded on the New York Stock Exchange and currently on NASDAQ, that provides medical infusion products to patients in their homes. Such products include, for example, anti-infective, chemotherapy and hemophilia treatments. Since these are medical products, Coram is required to comply with "Stark II," a federal law that places certain restrictions on the equity structure of companies that provide medical services; the company must maintain shareholders' equity of, at least, $75 million if it is publicly traded.[1]

Coram was a company with significant debts, totaling $250 million, owed to a number of creditors (the "Noteholders"), including Appellee Cerebus. Appellees are alleged to have conspired to use the requirements of Stark II to send Coram into bankruptcy, so that it would emerge from the Bankruptcy proceedings as a private corporation owned by the Noteholders. In 1999, according to Appellants' allegations, Feinberg, who was the CEO of Cerebus, as well as a member of Coram's Board of Directors, induced the board to hire Crowley as a consultant to oversee the then CEO of Coram, Richard Smith. Apparently, Smith was unhappy with this arrangement and resigned soon thereafter.

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1. Stark II literally provides that medical companies cannot treat patients who are referrals from physicians who are also stockholders of that company. There is an exception for public companies whose shareholders' equity exceeds $75 million. Practically, since a company has little ability to regulate who might buy their stock in the open market, and consequently cannot determine which of its referrals might come from physician-stockholders, medical companies must either be publicly traded and have shareholders' equity above the $75 million floor or be privately owned.

Feinberg then arranged for the election of Crowley as CEO of Coram in November of 1999. Neither Feinberg nor Crowley informed the board that Crowley had been an employee of Cerebus, or that Crowley was under contract with Cerebus to obey Feinberg's instructions as to the direction of Coram. Crowley was to receive substantial compensation for his cooperation.

Appellants allege that Crowley became aware, soon after his installation as CEO, of Coram's need either to arrive at $75 million in equity or to go private in order to assure compliance with Stark II. Crowley found out that Coram would not qualify for the equity exception under Stark II as of the end of 2000. Therefore, measures needed to be taken to deal with the situation. Crowley, putatively at Feinberg's direction, then changed the business plan. Instead of trying to expand the business of the company, as his predecessor had done, he began to sell off some of Coram's subsidiary businesses. Appellants allege that some of these sales were at far below their market value, all with the purpose of raising cash income in the short term in order to service the debt obligations of Coram. These sales and the general alteration of the course of business of Coram were allegedly part and parcel of Defendants' master plan to send Coram into bankruptcy so that it could reemerge from Chapter 11 proceedings as a private corporation.

On August 8, 2000, Coram issued a statement to the press regarding its intention to file for Chapter 11 protection with the objective of emerging in such a state as to assure compliance with Stark II. In the statement, they revealed that the emergence from bankruptcy would terminate the

current shareholders' interest in Coram and that no recovery would be available for those shareholders. On September 13, 2000, another statement was issued. This statement included the quotation from Crowley that "[i]ndependent financial advisors advised us that there were no viable options for new financing and that the value of the Company is less than the value of the debt. . . ." Appellants allege that they sold their stock as a result of these statements.

II.

Rule 10b-5, promulgated pursuant to 15 U.S.C. § 78(b), commonly known as § 10(b) of the Securities Exchange Act of 1934, makes it unlawful for any person "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading . . . in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5(b). "To state a valid claim under Rule 10b-5, a plaintiff must show that the defendant (1) made a misstatement or an omission of a material fact (2) with scienter (3) in connection with the purchase or the sale of a security (4) upon which plaintiff reasonably relied and (5) that the plaintiff's reliance was the proximate cause of his or her injury." *Semerenko v. Cendant Corp.*, 223 F.3d 165, 174 (3d Cir. 2000); *See Weiner v. Quaker Oats Co.*, 129 F.3d 310, 315 (3d Cir. 1997).

Appellants allege that Crowley had a contract with Cerebus and Feinberg in violation of his fiduciary duties to Coram. The failure to reveal that contract and the breach of fiduciary duty is, appellants argue, actionable under Rule 10b-5.

Generally, an omission does not, however, by itself, violate Rule 10b-5. There must be an affirmative misstatement that is rendered misleading by the alleged omission. Allowing the Appellants to recover based merely on the failure to disclose the underlying breach of fiduciary duties would allow recovery for claims related to virtually any mismanagement of the company, which are properly left to state law control. As we held in *Craftmatic Sec. Litig. v. Kraftsow*, 890 F.2d 628, 638-39 (3d Cir. 1989), "we must be alert to ensure that the purpose of *Santa Fe*[2] is not undermined by artful legal draftsmanship; claims essentially grounded on corporate mismanagement are not cognizable under federal law." *Id.* (quotations omitted). Thus, the issue becomes whether there was anything in the statements of August 8 and September 13 that was rendered misleading by the alleged omissions. We agree with the District Court that there was not.

In their brief before us, the Appellants claim that the two press releases, because of the alleged omissions, conveyed a number of misimpressions. Specifically, they argue that the press releases "created the impression that Coram (1) has an urgent need to bring itself into compliance with the equity requirements of "Stark II" by December 31, 2000; (2) could *only* do so by restructuring itself as a private corporation; and (3) would therefore be a private corporation

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2. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 479 (1977), the Court held that Congress did not intend § 10(b) to regulate "transactions which constitute no more than internal corporate mismanagement." More directly, a breach of fiduciary duty without a material misrepresentation, omission, or deception, violates neither the statute or the rule. *Id.* at 476.

by December 31, 2000." Ap. Brief at 39 (emphasis in original). Appellants' argument fails because these alleged misimpressions have not been shown to be false or misleading.

Appellants cannot challenge the truth of (1) above, with or without the alleged omissions; the parties disagree about the possible solutions to the Stark II problem and the reasons for it, but not its existence. The truth of (3) above is likewise undisputed if one accepts the truth of the second statement. Thus, our inquiry must focus on whether the statement/ impression that Coram could *only* remain in compliance with Stark II if it restructured itself as a private corporation is misleading in light of the alleged omissions.

The impression at issue, that Coram had no options available to it, other than bankruptcy, for Stark II compliance, is not misleading. The only alternative option identified by Appellants is a debt-equity exchange like the one that eventually occurred after the bankruptcy plan was rejected by the bankruptcy court. However, debt-equity exchanges could take place only at the option of the Noteholders.

The only way in which Appellants might argue that this impression is misleading, and they do, is that the knowledge of the breach of fiduciary duty would have led them to doubt the statements and to question whether the actions described were in the best interests of the company. However, this is the allegation and claim of every victim of a fiduciary breach; allowing such a claim under 10b-5 would be tantamount to allowing "artful legal draftsmanship" to undermine the purposes of *Santa Fe. Craftmatic*, 890 F.2d at 638-39. "When

the incremental value of disclosure is solely to place potential investors on notice that management is culpable of a breach of faith or incompetence, the failure to disclose does not violate the securities laws." *Werner v. Werner*, 267 F.3d 288, 299 (3rd Cir. 2001) (quoting *Craftmatic*, 890 F.2d at 640).

III.

The purpose of the § 20(a) claim is to impose liability on Feinberg and Cerebus, who are not alleged to have been directly responsible for the putative misstatements or omissions. The existence of a Rule 10b-5 claim, however, is an essential element of the § 20(a) claim. Since we find that Appellants have not alleged a viable claim under Rule 10b-5, they have, likewise, failed to allege a claim under § 20(a).

IV.

Appellants attempt to assert a claim for breach of fiduciary duty in a direct, rather than a derivative, suit. They make this attempt in order to gain standing to sue; as former shareholders, they cannot maintain a derivative suit. They face an uphill battle against a mountain of case law. Since Coram is a Delaware corporation, Delaware law applies to matters of corporate governance. *See Boyer v. Travelers' Protective Ass'n*, 75 F.2d 440, 441 (3d Cir. 1934).

"To determine whether a complaint states a derivative or an individual cause of action, we must look to the nature of the wrongs alleged in the body of the complaint, not to the plaintiff's designation or stated intention." *Lipton v. News Int'l, PLC*, 514 A.2d 1075, 1078 (Del. 1986) (citing *Elster v.*

American Airlines, Inc., 100 A.2d 219, 223 (Del. Ch. 1953), and *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1069-70 (Del. Ch. 1985)). "Delaware courts have long recognized that actions charging 'mismanagement which depress the value of the stock allege a wrong to the corporation; i.e., the shareholders collectively, to be enforced by a derivative action.' " *Lewis v. Spencer*, 577 A.2d 753, 1990 Del. Lexis 154, *5 (Del. 1990) (quoting *Kramer v. Western Pacific Industries, Inc.*, 546 A.2d 348, 353 (Del.1988)). "A claim of mismanagement resulting in corporate waste, if proven, represents a direct wrong to the corporation that is indirectly experienced by all shareholders. Any devaluation of stock is shared collectively by all the shareholders, rather than independently by the plaintiff or any other individual shareholder." *Kramer*, 546 A.2d at 353. "[A] plaintiff alleges a special injury and may maintain an individual action [only] if he complains of an injury distinct from that suffered by other shareholders or a wrong involving one of his contractual rights as a shareholder." *Lipton*, 514 A.2d at 1078.

Appellants argue, first, that *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243 (Del. 1999), has substantially overruled *Kramer* and applies to the facts in this case. In *Parnes*, a shareholder brought a suit, dismissed by the Chancery Court as derivative, but upheld by the Supreme Court as direct. However, as the District Court found, the holding of *Parnes* seems limited to merger situations. The *Parnes* Court said, "[i]n order to state a direct claim with respect to a merger, a stockholder must challenge the validity of the merger itself, usually by charging the directors with breaches of fiduciary duty resulting in unfair dealing and/or unfair price." *Id.* at 1245.

Furthermore, it is clear that *Parnes* did not overrule *Kramer.* The court, in *Parnes*, acknowledged the rule set forth in *Kramer*; it simply distinguished it. *Id.* The court stated that they were allowing a claim based on the validity of the merger, not on the price received. Furthermore, subsequent to *Parnes*, Delaware courts have alluded to the standard set out by *both* cases. *See Bradley v. First Interstate Bancorp*, 748 A.2d 913, 913 (Del. 2000) ("[T]he Court concludes that, in ruling that Plaintiff Below-Appellant had pleaded derivative claims, the Court of Chancery correctly applied the standards announced by this Court in *Kramer* . . . and *Parnes*. . . ."). The case before us does not involve a merger situation and, therefore, is distinguishable from the exception to *Kramer* set forth in *Parnes.* As a result, Appellants are required to allege a injury special to them in their individual capacities.

Appellants cite other cases in support of their position that these circumstances allow the maintenance of a direct suit. The thread common to these cases is the merger or other forcible alteration in the status of the shareholder. There is no such occurrence here; Appellants *chose* to sell their shares. This distinction is fundamental. Since they chose to sell their shares, Appellants' allegations of injury center, as they must, around the price at which they sold those shares. Since "[a]ny devaluation of stock is shared collectively by all the shareholders, rather than independently by the plaintiff or any other individual shareholder," *Kramer*, 546 A.2d at 353, this injury will not suffice to maintain a direct suit.

Appendix A

Almost as an afterthought, Appellants argue that there was individual, and, therefore, special, harm to those shareholders who sold their shares, because only those who sold lost the right to sue. However, shareholders who sell their shares always forfeit the right to sue in derivative claims. If we were to allow a direct claim because shareholders sold their shares and, thus, lost their right to sue, the albeit thin line between direct and derivative claims would disappear entirely; any time that a shareholder sold stock and, thereafter, became aware of a breach of a fiduciary duty, she could claim a direct injury and maintain a claim for breach of fiduciary duty. Because so holding would obviate the distinction between direct and derivative suits, we cannot so hold.

Appellants have alleged no special injury and their suit is, therefore, derivative in nature. Since they are no longer shareholders, they lack standing to assert such a claim.

V.

Appellants argue that the District Court improperly dismissed their common law claims for fraud and deceit. However, they do not discuss the elements of those claims, nor do they present any argument or citations supporting their claims. Appellants' "brief is devoid of argument with respect to" the Common Law claims and, therefore, those claims should be deemed waived. *Surace v. Caterpillar, Inc.*, 111 F.3d 1039, 1047 n. 8 (3d Cir. 1997).

Appendix A

VI.

We affirm the district court's order dismissing the complaint for failure to state a claim under Rule 12(b)(6).

TO THE CLERK:

Please file the foregoing not precedential opinion.

/s/ Walter K. Stapleton
Circuit Judge

APPENDIX B — EXCERPTS OF TRANSCRIPT OF PROCEEDINGS DATED MAY 6, 2002 AND ORDER DISMISSING COMPLAINT WITH PREJUDICE DATED MAY 6, 2002

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY
CIVIL NO. 00-05509

FURST, et al.,

Plaintiffs,

-vs-

FEINBERG, et al.,

Defendants

OPINION

Newark, New Jersey
May 6, 2002 11:30 a.m.

* * *

THE COURT: The posture of the case at present is that at the hearing before me on April 29, 2002, plaintiffs explained their theory of the case. They claim that the defendants planned to the press the price of Coram shares in order to create the impression that stockholder shares were [3] losing value and eventually would become worthless, which would justify a bankruptcy reorganization in which the company was taken private.

Appendix B

Plaintiffs argue that the defendants perpetrated a fraud upon the market for common stock shares of Coram in order to artificially depress the trading prices for said shares. And I quote from the paragraph 3 of the complaint in stating this. In all plaintiffs alleged that the defendants want to assume ownership and control of Coram by taking the company private and not compensating the plaintiffs for their shares of stock, i.e. steal the equity. In August 2000 CEO of Coram filed for bankruptcy and twice submitted a reorganization plan which has been rejected as it turns out by the bankruptcy judge. Plaintiffs main evidence undisclosed employment deal between CEO Crowley and Cerberus while Crowley functioned as chairman of the board and CEO of Coram. That's set forth in paragraph 6 of the complaint.

In fact, it's that deal of upon which the bankruptcy reorganization has apparently foundered. Off the record.

(Discussion held off the record).

THE COURT: Back on the record. The defendants argue that plaintiffs case consists of corporate waste and management claims and fiduciary relationship breach claims. And as result they argue the case belongs to Coram for harm [4] done to the company itself. Since plaintiffs are no longer shareholders of Coram, defendants argue, plaintiffs cannot bring a derivative suit against the company. They point out that the — the suit in this court mirrors a proposed derivative suit framed for the bankruptcy court where Coram shareholders have challenged the reorganization.

Appendix B

The defendants claim plaintiffs' suit belongs in bankruptcy court and cannot be brought here. Defendants' attack on the complaint is that it raises only derivative claims, and since plaintiffs are no longer shareholders, plaintiffs cannot complain about harm to Coram based on corporate waste or breach of fiduciary duties.

In reply plaintiffs cite to Parnes versus Valley Entertainment Corp., appearing 722 A.2d 1243, a decision of Delaware Supreme Court in 1999 and Rochez Brothers Inc. versus Rhoades 491 F.2d 402 (3d Cir. 1974) to support their position that even though they raised derivative claims, the harm to them is direct. Plaintiffs claims that defendants caused the stock price to drop and induced them to sell at a loss causing them to lose money on the value of the stock.

Now, counsel, and Mr. Godnick, in particular, I am glad you are here because you are the only litigant here, or your client is, and it only appears in your briefs and in your reply brief at that, that aside from being in federal court because of the securities claims, in counts one and two [5] this matter is diversity action.

* * *

[7] * * *

THE COURT: The pleading standards, just for the benefit of the opinion and the record. The general pleading requirements as we know in this motion that are expressed in Rule 12(b)(6) are heightened through the application of Rule 9(b), which requires that, "all averments of fraud or

mistake the circumstances constituting fraud or mistake shall be stated with particularity." In order to prevent false or under substantiated charges. See, for example, Rolo versus City Investing Company Liquidating Trust 155 F.3d 644, 658 (3d Cir.1998).

[8] Rule 9(b)'s heightened pleading requirements restate the long standing rule at common, that a law fraud claim should state distinctly a particular acts of fraud or coercion relied specifying by whom and in what manner they perpetrate, with such definiteness and reasonable certainty that the court might see if proven, they would warrant setting aside of the, and the case I am citing from, the judgment. Chamberlain Machine Works versus United States 270 U.S. 347, 349. (1926). A plaintiff must prove that who, what, when, where and how the first paragraph of the newspaper story. A cite that I think really brings business it all down to an accessible standard. And that comes right out of In re Advanta Corp. Securities Litigation 180 F.3d 525 (3d Cir. 1999).

Securities fraud allegation must also comply with PLSRA. Reviewing the legislative purposes of that relatively new statute, the Third Circuit concluded that plaintiffs can comply with the scienter requirements in the PLSRA, "alleging facts establishing a motive and an opportunity to commit fraud or by setting forth facts of either reckless or conscience behavior." In re Advanta 180 F.3d at 534. Motive and opportunity must be 'as Advanta indicates supported by facts stated with particularity and must give rise to a strong inference of scienter." Catchall allegations that defendants would benefit from the wrongdoing and had the [9] opportunity to commit fraud are not sufficient.

Appendix B

Turning then to the federal counts in the complaint: Counts one and two. In their complaint, plaintiffs allege as part and parcel of the scheme to defraud described herein, Feinberg and Crowley secretly agreed to act together to operate Coram for a benefit of the defendants Cerberus Partners contrary to the interests of Coram itself. The result in breach of fiduciary duties owed by Feinberg and Crowley, Coram benefitted Crowley and Cerberus and caused substantial damage to Coram. This is from the complaint paragraph 5.

Plaintiffs also allege that, "the actions that Crowley took in breach of his fiduciary duties in order to benefit Cerberus included but were not limited to (1) adoption of a business strategy that focused on liquidation of assets and reductions of debt even when such action were adverse to the interests of Coram and taken solely for benefit of Cerberus and the other Noteholders. And by Noteholders, the definition of Noteholders in the complaint are the three principal lenders.

(2) failure to retain and consult independent financial advisors to explore, inter alia, viable refinancing options; (3) failure to explore opportunities for business combinations and capital infusions and strategies to grow Coram; (4) payment of interest to Cerberus and other holders [10] of notes that was not required by the terms of the note. (5) failure to use reasonable business judgment and negotiations of Cerberus concerning use of proceeds of asset sales; (6) failure to use processes that were entirely fair, or in some cases fair at all in dealings with Coram's shareholders. (7) unconscionable delay in implementing steps necessary to comply with government regulations in order to posture Coram's bankruptcy filing as an emergency; (8) other steps designed to reduce the real annual apparent value of Coram and thereby vast facilitate Cerberus' scheme and conspiracy."

Appendix B

That appears, that long quote appears in paragraph 10 of the complaint.

I note that these excerpts front the complaint are almost exactly the same as passages in the proposed derivative lawsuit being considered by the trustee which appears in Exhibit 9 to the record.

In order to establish a claim under Section 10(b) and Rule 10(b)(5) plaintiffs must plead six elements. (1) that the defendant made 'a misrepresentation or omission of (2) a material (3) fact; (4) that the defendant acted with knowledge of recklessness; and (5) that the plaintiff reasonably relied on misrepresentation or omission; and (6) consequently suffered damage.

Each of the plaintiffs' claims that I just outlined by citing to the complaint directly, appears to me to relate [11] to Coram's management and appears to support harm to the company rather than setting forth a misrepresentation of a material fact that the plaintiffs reasonably relied on and suffered damage as a result of. Such claims address harm to the company rather than to the shareholders.

In response to those concern that the Court expressed in oral argument and in response to the attack on the complaint that the defendants make, the plaintiffs turn to the Parnes decision of Delaware Supreme Court, to demonstrate under Delaware law why they believe their claim, which even they frame in terms of a breach of fiduciary duties, should be permissible as a direct claim under the securities laws.

Appendix B

Turning to Pares then. There, the plaintiff Linda Parnes challenged a merger between Valley and the Hilton Hotels Corporation. The analysis of the Delaware Supreme Court focused on business judgment and the board of directors of Valley and raised the issue of corporate waste. Even though corporate waste was in fact the one claim left to Parnes, after a whittling down of all of the other claims by the chancery court, Parnes was found contrary to chancery court's initial decision, to be eligible to bring her claims.

The analysis of the Delaware Supreme Court, as I read Parnes, was that Linda Parnes was directly attacking the [12] merger as opposed to the process by which the merger was taking place. And therefore, attacking the fact and not the process, she had standing to raise the issue under Delaware law. Thus, she escaped, as it were, the noose of having brought merely a derivative claim even though the analysis was focusing on corporate waste.

I think it's important to point out in looking at Parnes that it is clear, that once having established, as the Delaware Supreme Court found she did establish, that actions and demands of the CEO of Valley, Arthur Goldberg, appeared to be outside of the ream of proper and legal behavior for the CEO. The decision had to focus necessarily on the board of director's actions. Because after all they voted on the merger. And in that analysis, the Delaware Supreme Court was confronted with the corporate the waste argument, because what they were looking at the board of directors decisionmaking. Because they were analyzing the fact of the merger itself and the conclusion to be drawn from the pleadings that only a decision outside of the realm of logical

corporate behavior would support a merger given what appeared to be outrageous demands by Goldberg, in that context the issue of corporate waste could be examined, albeit the complainant was alleging corporate waste.

By analogy plaintiffs seek to use that analysis in there case here. And the viability of Dr. Furst's complaint [13] would have to depend upon whether his complaint was direct or derivative the same way the viability of the Parnes complaint would have to depend upon whether Parnes had standing as someone directly harmed.

If the allegations here support only a derivative claim for harm to Coram, then notwithstanding anything that went on in the Parnes decision, Dr. Furst it would appear, would no longer be able to pursue his claim once he sold his stock.

In Parnes, the Delaware Supreme Court found that to state a direct claim with respect to a merger, a stockholder must challenge the validity of the merger itself usually by charging directors with breaches of fiduciary duty resulting in unfair dealing and/or an unfair price.

However much I try to derive some direction from that observation, I don't find that the fact pattern in Pares applies specifically enough to this case. And that the analogy as a result does not fit.

As defendants argue, Parnes discusses the plaintiffs' standing to bring claims against the directors within an exception in Delaware law that permits plaintiffs' suits brought by stockholders that attack the fairness of a merger qua merger. See Parnes 722 A.2d 1245. This exception exists within the context of a merger only.

Appendix B

I don't find that it could stretch to provide for a [14] direct stockholder's suit based upon a breach of fiduciary duty. The court's decision in Parnes, and by that I mean, the Delaware Supreme Court's decision in Parnes is fact specific. And I find that it is bearing on this federal securities claims is minimal. Parnes in short does not persuade me that plaintiffs' claims which avert harm done to the company are other than derivative. And as only former shareholders and not actual shareholders of Coram, I do not find that the plaintiffs stand in the shoes of a proper plaintiff to bring this derivative claim against the company.

Moving to another predicate. The plaintiffs assert that the failure by the company to disclose Crowley's business relationship to Cerberus, in and of itself satisfies the materiality test and all particularity pleading requirements. In this Circuit, "material information is information that would be important to a real investor in making his or her investment decision." This according to Oran versus Stafford 226 F.3d 275 (3d Cir. 2000), citing to the oft cited to case of Burlington Coat Factory Securities Litigation 114 F.3d, 1410. (3d Cir. 1997). Undisclosed information is generally considered material if there is a substantial likelihood that the disclosure would have been viewed by the reasonable investor as having significantly altered the total mix of information available to that [15] investor. In re Westinghouse Securities Litigation 90 F.3d of 696, 714 (3d Cir. 1996). So material fact that is undisclosed would have to have a bearing on the shareholder's decisionmaking, would have to be something that reasonable investor would want to know, and that may affect the value of the stock.

Appendix B

Now, in looking to where this material information was literally omitted and therefore where the plaintiffs rely upon their lawsuit with respect to material misstatements, I look at the news releases of August 8, 2000 and September 13 2000, as I am directed to by the plaintiffs in their complaint. We have talked about the contents of those press releases when we held oral argument.

It's clear that undisclosed in both of these press releases is the employment relationship between Crowley and Cerberus. Plaintiffs point to these two press releases in paragraph 65 of the complaint as containing false and fraudulent misstatements and to the omission of the fact of their relationship. The August 8, 2000 statement provides that, "the company's proposed restructuring plan provides no recoveries for shoulders of the company common stock currently outstanding.

Plaintiffs have indicated that reading that, they acted responsibly and inevitably in selling their stock insofar as there was no recovery planned for them as holders [16] of common stock. The September 13, 2000 press release states, "the company's election to file for chapter 11 was solely for the purpose of reducing and restructuring debt and maintaining compliance with all applicable federal laws and regulations."

The August 2000 statement makes the same representation. The September release also stated that, "independent financial experts advised us that they were no viable options for new financing and that the value of the company is less than the value of the debt." And that the

plan of reorganization submitted by Coram Health Care to the court on August 8, 2000 anticipates emergence from bankruptcy as a privately held company by December 31, 2000.

What I find is missing in the complaint is a particularized and persuasive theme or logical description that would link the omission of the Cerberus Crowley relationship with the plan to defraud. Because clearly a reading of the substance of these two fairly long press releases does not reveal to me misstatements. Rather, and I think that this is the gravamen of plaintiffs argument, what's missing was information about the Crowley Cerberus relationship. But what was also missing is how that omission affected the value of the stock so that the omission of the relationship had a bearing on the truthfulness or accuracy of the information set forth in both statements.

[17] Clearly, the gravamen of plaintiffs' complaint is that Crowley had a powerful motivation to do what he could to foster the goals of Cerberus. The derivative inquiry on Coram's behalf is whether this powerful motivation actually interfered with Coram's interests.

Plaintiff in framing the complaint, and as I indicated is closely parallel to what is being framed in the bankruptcy court, says of course it did. But what is not particularized in the this federal securities lawsuit, and what is not revealed in any reading of the complaint, are facts demonstrating that the goal of Cerberus was achieved by devaluing Coram stock. And that to me is the necessary nexus in order to give these former shareholders a basis for filing this suit, or standing to file this suit.

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Plaintiffs, I believe, and I am persuaded under the law, plaintiffs must show nondisclosure of the relationship as central to the scheme to defraud. And remember, in order to persuade the Court to accept this lawsuit as one that is not derivative but expressive of direct harm to them, the scheme to defraud must have necessity incorporate depressing the value of the stock.

Instead I find plaintiffs' theory is, you didn't disclose and therefore everything you did created the harm to me as a stockholder, that harm being the lowering of the value of the stock. In other words, a theory that is not [18] really much stronger than post hoc propter hoc, and clearly under the law more must be demonstrated in order to satisfy materiality standards.

Plaintiffs have failed to show how the complaint sets up a link between their allegations is of the defendants' driving the price down on the stock and the acts that they allege are part of the breach of fiduciary duty, i.e., the undisclosed or existence of the employment relationship, which as undisclosed would affect their rights as shareholders.

Plaintiffs are asking the Court, as it were, to second guess business management decisions, and I believe that all of the eight or nine claims that are made in paragraph 10, steps that are outlined in paragraph 10 of the complaint, are business management decisions. And yet plaintiffs allege no overt activity, no clear activity on the part of Coram and Cerberus, or Crowley and Cerberus, undertake it to drive the stock price down and no material misstatements in the two press releases central to this particular scheme.

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The only driving part in the press releases is the assertion that the plan is to take the company private and not to provide a recovery to the stockholders. Plaintiffs say that's the plan, the plan is materially infected and affected by the undisclosed employment relationship. And [19] plaintiffs assert that that is enough. And no further link in terms of activity or misstatements need be shown. And that is where I disagree with plaintiffs.

Now plaintiffs said however, look to the Rochez case, Rochez versus Rhoades 491 F.2d 402 out of this Circuit, and you will see, Judge, how that omission is material. Rochez was an insider owner. He owned 50 percent of the stock of the company in question. And his partner and owner of the other half of the company, Rhoades, was in process of buying out Rochez. Rhoades failed to disclose to Rochez that afterwards he intended to turn around and sell all of the stock to a third party, a buyer named Royce. Off the record.

(Discussion held off the record).

THE COURT: Back on the record. In the instant case, there are thousands of stockholders others and of the stockholders affected by the company's going private some held on to their stock. They are in fact the unhappy stockholders who are challenging and immediately did challenge the reorganization plan in the bankruptcy court.

Rochez's closely held corporation such involves the nondisclosure of a piece of information central to the sale price, a nondisclosure that as a reasonable stockholder one-half of corporate stock, surely Rochez would want to know

about and need to know about as a material piece of [20] information before making a sale or buying of stock.

That makes cerise to me given the particular facts of Rochez. But here where a number of the stockholders held on to their stock and did complain to the bankruptcy court, I find that plaintiffs made a decision of their own to sell the Coram stock rather than to hold on to it. In other words, the inevitability, the link between this material omission and the decision of stockholders, I don't find is the kind of direct and material running that the omission set up in the Rochez case when reviewed it.

That distinction I find belies a simplistic application of the test that a nondisclosure is material if any reasonable shareholder would want to know about it, and that the nondisclosure might affect the price of the stock. That's a very broad category. But I believe that under the law, and certainly in this case, we have to go further and show the effect of that nondisclosure on the sale price. And that is what is missing here.

And I think that again, since it was Rochez that plaintiffs particularly directed me to and it is a Third Circuit case, I emphasize that the nondisclosure that Rhoades, who took pains to hide the existences of Royce from Rochez, was in fact engaged in a deal with Royce to sell the stock to Royce. That event and that deal and that relationship has I find in direct bearing on the value of the [21] stock and should have been disclosed and the Third Circuit concluded to Rochez.

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Here, the undisclosed business relationship between Crowley and Cerberus simply does not portend, create, reveal, demonstrate an affect upon the value of the stock that these plaintiffs had sold. And therefore, I have taken very seriously and carefully analyzed the position of the plaintiffs that the Parnes case is instructive and the Rochez case is instructive, and do not find that they persuade me that the serious problems that the plaintiffs face as former shareholders in mounting the securities lawsuit are overcome by the reasoning in either Parnes or Rochez.

As a consequence, I am dismissing the first claim of the complaint brought under Section 10(b), and the second count under Section 20(a) of the Securities Act, since the proofs of the second would rest upon the proof of an underlying violation by the controlling person or entity. And since I find no independent securities violation under Exchange Act, I could not possibly find what is necessary to sustain a Section 20(a) claim.

The third claim for fraud and deceit and the fourth claim for breach of fiduciary duties are dismissed as a necessary consequence of my analysis leading me to dismiss count one. The claims are based upon the same facts of fraudulent misstatements and omissions on which the federal [22] claims rest, and I find they are the harm brought to the corporation, clearly a breach of fiduciary duty one is, and the failure to assert a material omission renders, or is a failed omission in terms of the elements of the fraud claim that would otherwise have to be met.

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Not finding materiality, in other words, in a nondisclosure, I cannot find that plaintiffs have an advert in this complaint the necessary elements for a fraud claim, consequently Counts three and four fail. Count five, which seeks a constructive trust, would rest upon viability of the claims in counts one through four. And since I do not find that they are viable, count five must be dismissed as well.

I therefore grant the motion of the defendants and I am dismissing the complaint. Anything further, gentlemen?

* * * *

Appendix B

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Civ. No.: 2:00cv05509 (KSH)

Hon. Katherine S. Hayden, U.S.D.J.

ALAN FURST, M.D. and MICHAEL S. HARRISON, ESQ., individually and on behalf of all persons similarly situated,

Plaintiffs,

- against -

STEPHEN FEINBERG, DANIEL CROWLEY, DONALD J. AMARAL, CERBERUS PARTNERS, L.P., CERBERUS ASSOCIATES L.L.C., CERBERUS CAPITAL MANAGEMENT, L.L.C., CRAIG COURT, INC., GOLDMAN SACHS CREDIT PARTNERS, L.P., FOOTHILL CAPITAL CORPORATION, and JOHN DOES 1-100,

Defendants.

ORDER DISMISSING COMPLAINT
WITH PREJUDICE

THIS MATTER having been opened to the Court by Schulte Roth & Zabel LLP and Lowenstein Sandler PC, attorneys for defendants Stephen A. Feinberg, Cerberus Partners, L.P., Cerberus Associates L.L.C., Cerberus Capital Management, L.P., and Craig Court, Inc. (the "Cerberus Defendants"), on a motion to dismiss the plaintiffs' Complaint with prejudice pursuant to

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Rule 12(b)(6) of the Federal Rules of Civil Procedure; and the Court having considered the papers filed in support thereof, and in opposition thereto; and the Court having heard and considered the arguments of counsel; and for good cause shown;

IT IS on this 6th day of May 2001, ORDERED as follows:

1. The Cerberus Defendants' Motion to Dismiss the Complaint is GRANTED, and the Complaint is hereby dismissed with prejudice.

2. Counsel for the Cerberus Defendants shall serve a copy of this Order upon all counsel of record within 5 days of entry.

s/ Katharine S. Hayden
Honorable Katharine S. Hayden, U.S.D.J.

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DENYING PETITION FOR REHEARING DATED JANUARY 14, 2003

UNITED STATES COURT of APPEALS
FOR THE THIRD CIRCUIT

No. 02-2357

ALAN FURST, M.D.;
MICHAEL S. HARRISON, ESQ., individually and on behalf of all persons similarly situated,

Appellants

v.

STEPHEN FEINBERG; DANIEL CROWLEY; CERBERUS PARTNERS, L.P.; SACHS CREDIT PARTNERS, L.P.; FOOTHILL CAPITAL CORPORATION; SCOTT R. DANITZ; SCOTT T. LARSEN; ALLEN J. MARABITO; DOMENIC A. MEFFE; VITO PONZIO, JR.; JOSEPH D. SMITH; RICHARD M. SMITH; DONALD J. AMARAL; WILLIAM J. CASEY; L. PETER SMITH; SANDRA L. SMOLEY; RICHARD A. FINK; STEPHEN G. PAGLIUCA; JOHN DOES 1-100; CERBERUS ASSOCIATES, L.L.C.; CERBERUS CAPITAL MANAGEMENT, L.L.C.; CRAIG COURT, INC.; GOLDMAN SACHS CREDIT PARTNERS, L.P.

SUR PETITION FOR REHEARING

Appendix C

BEFORE: BECKER, *Chief Judge*, SLOVITER, SCIRICA, NYGAARD, ALITO, ROTH, McKEE, RENDELL, BARRY, AMBRO, FUENTES, SMITH and STAPLETON,*
Circuit Judges, and O'KELLEY,* *District Judge*

The petition for rehearing filed by appellants in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court en banc, the petition for rehearing is denied.

By the Court,

s/ [illegible] Stapleton
Circuit Judge

Dated: JAN 14 2003

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* Honorable William C. O'Kelley, United States District Judge for the Northern District of Georgia, sitting by designation. Judge O'Kelley's and Judge Stapleton's votes are limited to panel rehearing only.